



# Economic Indicators

Prepared by the Department of Finance • December 2001

*The purpose of this report is to keep policy makers apprised of changes in the national and local economies that the Montgomery County Department of Finance believes may impact current and/or future revenues and expenditures.*



*This report is also available through the Internet  
on the Montgomery County Web Page:  
<http://www.co.mo.md.us/services/finance/>*

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## ECONOMIC OVERVIEW

“The business cycle is alive and well.” Contrary to reports by some analysts a few years ago that growth will be sustained *ad infinitum*, economies do go through cycles of growth, exuberance, over supply, and bust. Moreover, with the longest running economic expansion over, the discussion on the economic outlook has now changed from when or if the national economy will enter a recession, to when will it end. According to officials at the National Bureau of Economic Research, the economy slipped into a recession in March 2001, following at least four quarters with decelerating growth. GDP numbers for the 3<sup>rd</sup> quarter 2001 indicate that the economy contracted 1.3% - a combination of considerably slower consumer and business spending, and inventory reductions.

The leading indicator for the national economy suggests that, once growth resumes in the early part of 2002, it will be modest rather than the robust growth usually associated with a post-recession period. Part of the reason is that, in contrast to previous recessions, this one is to a large degree the results of a lack of capital investment and inventory over-hang in the business sector. Granted, consumers pulled back spending, but it remains positive. Hence, growth will not rebound until businesses become profitable and increase hiring. Following some lag, largely due to currently greatly overpriced shares, stock markets will resume growth, and the business cycle begins anew.

It is important to review how the two players – business and consumers – reacted to the economic slow down leading up to this recession. When economic growth deteriorated and the bottom line on corporate balance sheets turned from black to red, it is

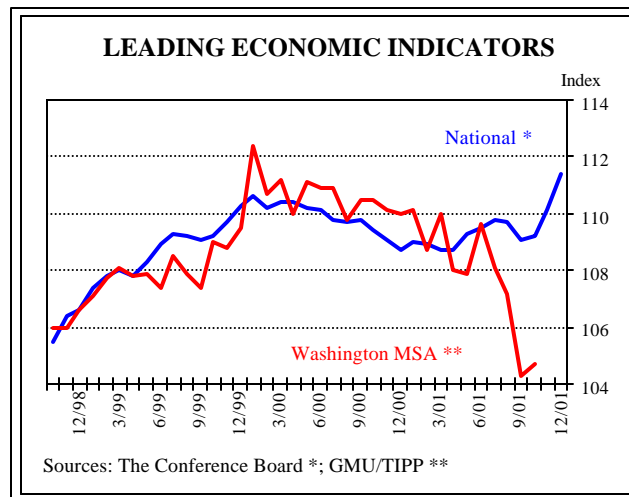
remarkable how fast conditions changed – from double-digit growth to double-digit declines. Faced with a drop in demand for product and services, businesses responded by cutting back production, reducing inventories and operating expenses (e.g., travel, benefits, bonuses), and laying-off workers.

Consumers, on the other hand, faced with considerably weaker labor market conditions and earnings growth (from employment and stock market), pulled

back spending from a solid 5% in the past few years to just 1% in the 3<sup>rd</sup> quarter 2001. To a large degree, lower energy prices, lower mortgage costs, and federal tax rebates increased the ability for consumers to spend. In addition, the sharp rise in housing values allowed some to take out equity, while dampening the impact from stock market losses in terms of personal wealth. This partly compensated for the drop

in employment, thus keeping consumer spending in positive territory and contributing to a less pessimistic consumer confidence than during the 1991 recession.

In comparing the national to the County economy, there are a number of important similarities. When businesses either reduced hiring or actually laid-off workers, payroll employment numbers that compare year-over-year change quickly changed from robust growth to very little growth, and to negative in the case of the national economy. Even though there are no data at the County level beyond June 2001, both trend lines show a remarkable similarity with respect to how businesses reduced labor costs. It also suggests that the County’s payroll employment growth, which fell from 6.1% in September 2000 to just 0.8% in June 2001, may be poised to turn negative during the 3<sup>rd</sup> quarter 2001 – similar to the national economy and the County’s during the last recession.



Unemployment has increased in both jurisdictions, from 3.9% to 5.8% nationwide, and from 1.5% to 2.7% Countywide. However, unemployment claims, which had jumped dramatically in October 2001, have slowed both in the nation and in Maryland, suggesting that labor markets are stabilizing.

Consumer spending is reduced significantly from 2000 levels. However, it appears that conditions are slightly better in the County than either in Maryland or the nation. This may be a function of a more stable labor market, lower unemployment rate, and higher earnings.

Construction, traditionally a prime economic barometer, indicates growth regionally, but is flat nationally by some measure, perhaps suggesting that, contrary to the national recession, economic conditions are considerably better in Maryland and Montgomery County. Measured thru November by the number of residential building permits, construction is up in the County (11.8%), Maryland (7.0%), and nationwide (3.5%). On the other hand, measured by the value of total construction (residential and commercial), the County is up 15% in 2001, compared to Maryland (9.2%) and the nation (0.1%). However, County data show that, even though the number of units rose, total construction costs of single-family residential houses is flat in 2001.

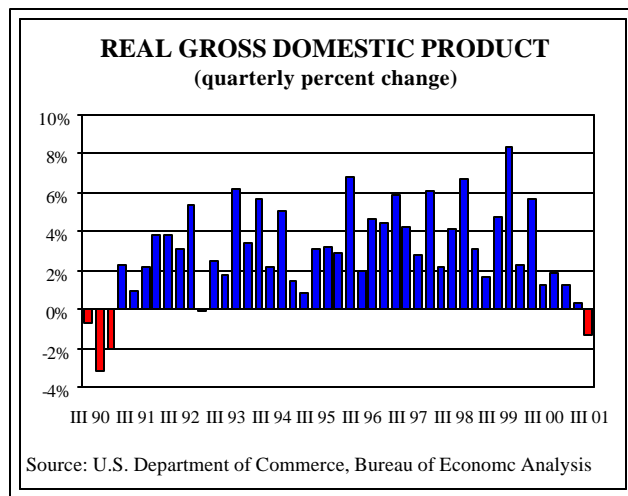
Data from the Board of Realtors show that residential housing sales are flat for the 2<sup>nd</sup> consecutive year in the County, compared to modest low single-digit growth nationally.

## SUMMARY

The County economy appears positioned to weather a recession better than the national economy. However, that doesn't mean it won't feel the down draft. In fact, it has already experienced a significant impact in some key economic areas. First, the labor market indicates that County businesses have either laid-off workers or cut back hiring to a significant degree. In short, there is little to no growth in employment in the near term. Second, in term of value, residential construction experienced no growth in single-family houses in 2001, while commercial construction of new

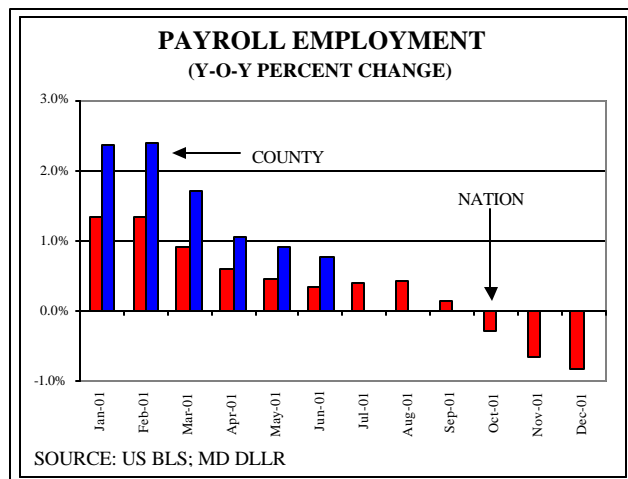
offices is expanding significantly at a time that existing office space is becoming available due to business failures or reductions, reaching a six-year high measured by the latest office vacancy rate. Third, after the 2<sup>nd</sup> consecutive drop in the stock markets, capital gains and the associated "wealth effect" (both of which were crucial to the County's consumer spending, housing market, and fiscal conditions during the recent five-year bull market) will be painfully absent this year. Fourth, while the aggressive series of interest rate cuts will stimulate the economy, it also cut the County's investment income by 2/3<sup>rd</sup> last year, with little relief expected in the subsequent year. Finally, the flip side of the fiscal stimulus package by the federal government, is that it reduces taxable income and, hence, County revenues.

In short, while economic conditions remain favorable in the County in terms of level of activity, growth has either evaporated or declined significantly in key areas – jobs, residential construction, residential housing market, retail trade – while in one key area – office construction – there is now an increased risk of over supply. On the positive side of the ledger, the County is benefiting from earlier trends, such as the growth in real property reassessments that reflect the sharp jump in housing prices, an unprecedented jump in mortgage refinancing, and the final receipts of recognized capital gain earned prior to the onset of the bear market. Undoubtedly, the County will weather this storm, but the five fat years that coincided with the unprecedented bull market, housing market, consumer spending, and job market, will be followed by a few leaner years with little to no growth. While no growth appears paltry, especially compared to the robust growth of the past few years, it beats the recession experienced in many jurisdictions, states, and the nation.



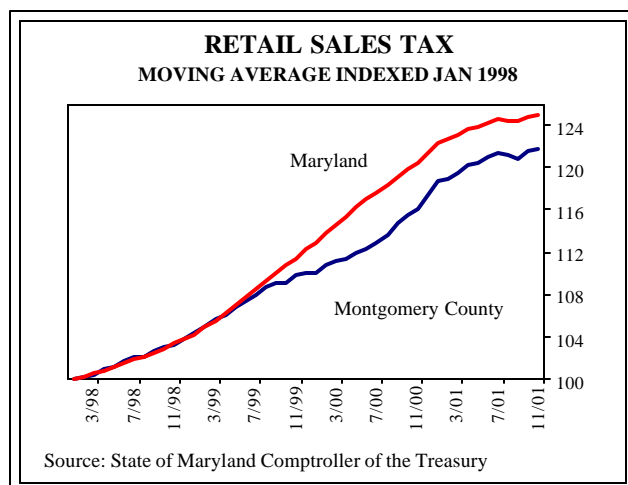
The longest running economic expansion is over. According to the National Bureau of Economic Research, the national economy officially entered a recession in the 2<sup>nd</sup> quarter of 2001. While measured by GDP that quarter was still positive - although at 0.3% barely - subsequent revisions are expected to revise that number further downward.

The 1.3% contraction in the 3<sup>rd</sup> quarter reflects decelerating consumer spending (PCE), and decreases in exports and inventory investments. Moreover, the 1% growth in PCE, considering that this component represents two-thirds of GDP, fell sharply from the 5% rate in the past few years.



Faced with declining corporate profits, businesses nationwide slashed payrolls by 1.4 million jobs in 2001. At the same time, unemployment jumped sharply from 3.9% one year ago to 5.8% in December 2001. As a lagging indicator, unemployment will continue to rise for some time, even as the economy begins to turn around.

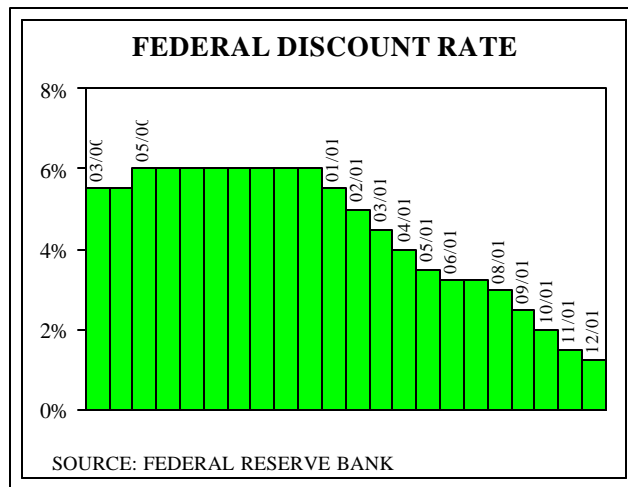
Even though the County's job growth remains stronger than the nation, it fell from close to 6% in 2000 to 0.8% in June 2001 - the lowest rate in 5 years and indicative of a serious pull back in the County's economy. Meanwhile, unemployment doubled to nearly 3% from last December.



Retail sales nationwide grew 3.4% in 2001 - less than half of the prior year. On the other hand, considering the recession and 9-11, consumers are surprisingly resilient - e.g., retail sales in the crucial 4<sup>th</sup> quarter were better than last year. Especially, motor vehicle (5.6%) and building material (5.4%) compensated for weaker non-durable goods sales.

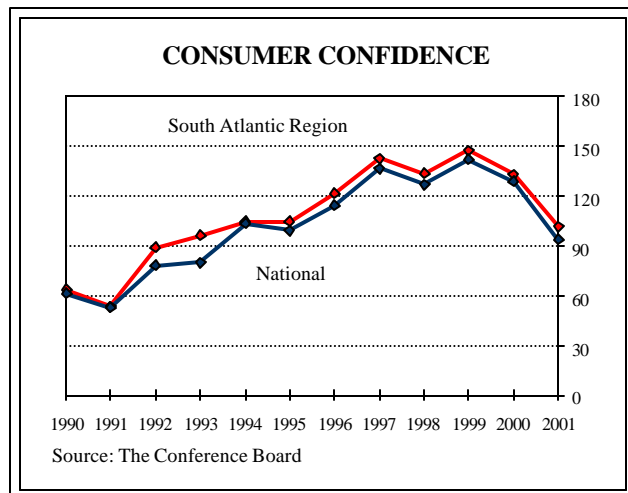
Measured by sales taxes thru November, the County grew 4.2%, down 1/3<sup>rd</sup> from last year, but better than the State. While most sectors remain strong - e.g., automotive (5.3%), apparel (9.6%), building material (10.9%) - there is weakness in furniture (-7.5%) and general merchandise (-0.1%).





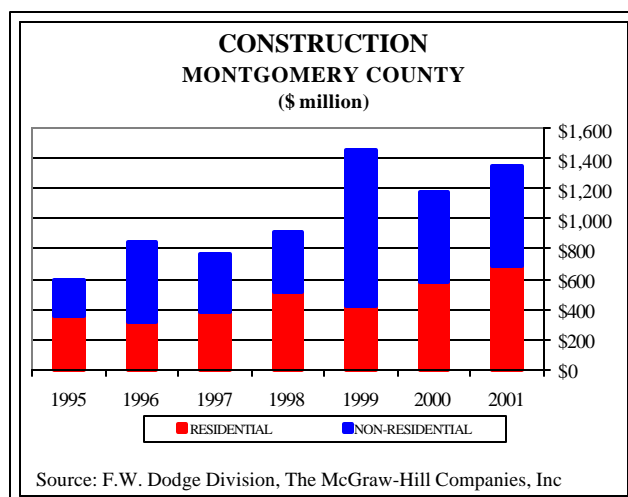
Faced with a national recession, the Feds continued to cut interest rates – a trend that started January 3<sup>rd</sup> 2001 with an interim meeting 50 basis point cut. Following each subsequent FOMC meeting, the discount rate was cut by either 50 (7 times) or 25 basis points (3 times) bringing the discount rate from 6.0% at the onset of 2001 to 1.25% by the end of the year – the lowest rate since 1948.

While these actions stimulate the economy by reducing credit card and other short-term rates, e.g., allowing car companies to offer 0% financing, it also negatively impacted the County's investment income yield which fell by 2/3<sup>rd</sup> in 2001.



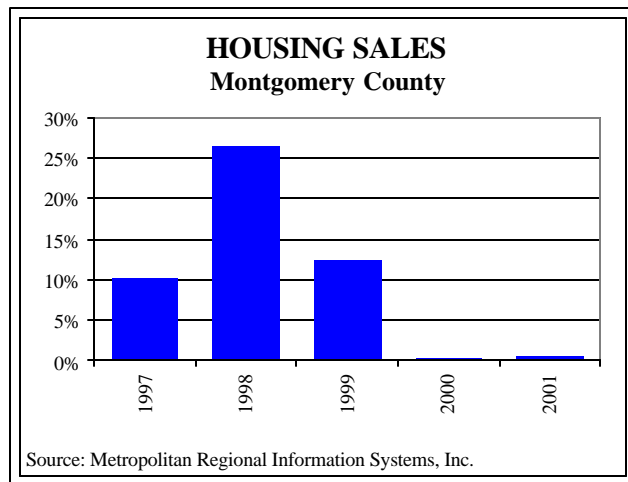
Even though consumer confidence dropped to a six year low at the close of 2001, despite the national recession, war in Afghanistan, and 9-11 terrorist attacks, consumers are less pessimistic than they were during the last recession.

Moreover, confidence is slowly improving following the October 2001 low, suggesting that economic conditions have reached a plateau. The modest improvement in short-term outlook and sharp jump in the expectations index, nationally and regionally, are consistent with a modest rebound in the economy by mid-2002. Separately, the University of Michigan Consumer Survey also indicates improvements in economic outlook.



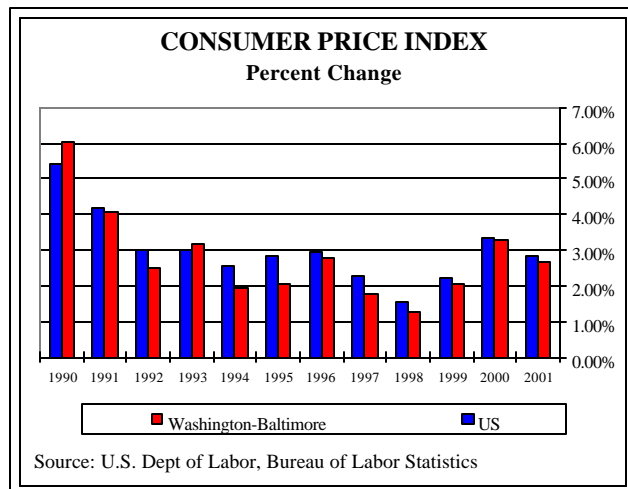
Construction was one of the best economic indicators for the County in 2001. Thru November 2001, the number of residential building permits jumped 12%, well ahead of Maryland (7%) and the nation (3.5%). Measured by valuation, residential construction jumped 17% for the year. However, this growth is entirely due to a tripling in new apartments, with single-family homes down 0.2%.

Non-residential construction projects surged 44% in 2001, while the value was up 14%. Particular strength is observed in the commercial sector – most notably an 85% jump in new offices adding 2.6 million square feet – double of last year.



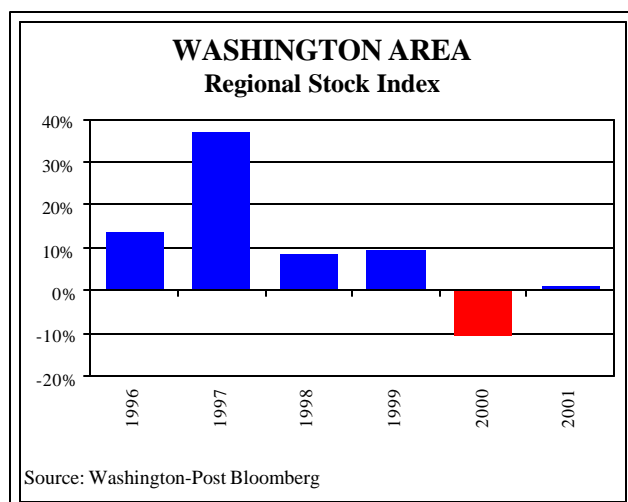
Considering the national recession and weaker job market, nationwide housing sales remain surprisingly strong. On the other hand, mortgage interest rates remain near-30 year lows, with a brief period in which rates fell to 1960s levels, allowing many to either enter the housing market or upgrade to bigger homes. Hence, existing (2.1%) and new home sales (3.9%) were better than in 2000.

Weaker housing sales in the County in the 2<sup>nd</sup> half of 2001 eliminated growth for the 2<sup>nd</sup> consecutive year. Even though lack of supply is partly responsible for the 0.5% growth, it also forced both average (8%) and median (11%) prices up sharply.



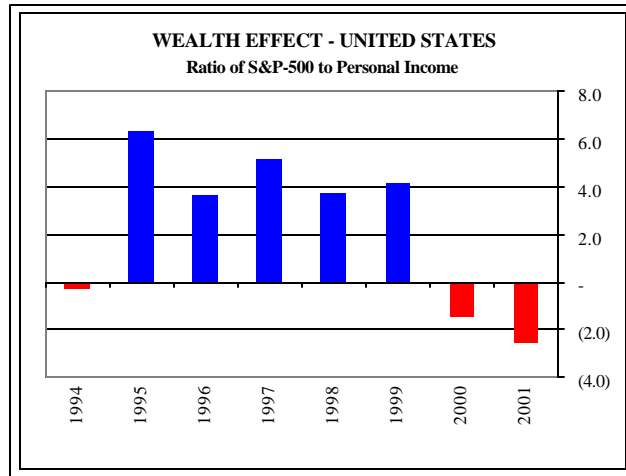
The jump in energy prices, notably natural gas, heating oil, and gasoline explain most of the growth in the CPI-U last year. In 2001, however, energy prices fell sharply, pushing down inflation to 2.9% nationally and 2.7% regionally. In fact, the 1.6% growth in December 2001 is the latest in a dis-inflationary trend observed throughout the year.

On the other hand, core inflation has crept up last year from levels observed in 2000. More specifically, the latest November 2001 regional CPI-U shows that prices rose 2.2% - a combination of rising prices for rent, food, and other services, but sharp drops in fuel and energy costs.



When the stock markets reopened on September 17<sup>th</sup>, share prices of regional companies were caught in the same down draft as national companies. While the big sell off pushed the Washington Post-Bloomberg stock index down 13%, that loss was less than half the experience of the broad based S&P 500 (-27%).

Even though a sharp rebound in the stock markets in the 4<sup>th</sup> quarter 2001, significantly reduced the losses for most indexes, only the regional stock index recorded a modest gain (1.3%). By contrast, the DJI (-7.1%), S&P 500 (-13.0%) and NASDAQ (-21.1%) all remained in negative territory for a 2<sup>nd</sup> consecutive year.

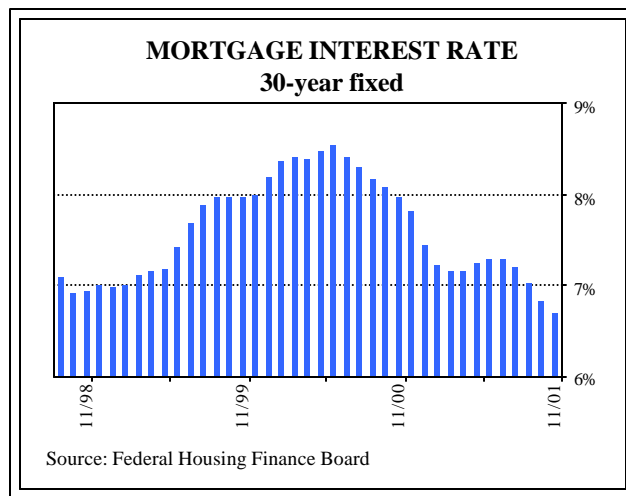


Strong economic growth, shifts in compensation (stock options), and greater investor participation, pushed stock markets to record highs by March 2000. While corporate earnings were rising, it was insufficient to support sky rocketing share prices (e.g., p/e ratio was 35 (8 in 1980) for S&P 500).

Even though stock markets have fallen sharply since then, corporate earnings have fallen even more, pushing the p/e ratio to a new record (40). Not surprisingly, that, at these prices, there is no growth in the stock market, while capital gains and the associated “wealth effect,” after falling for the 2<sup>d</sup> consecutive year, are unlikely to rebound soon.

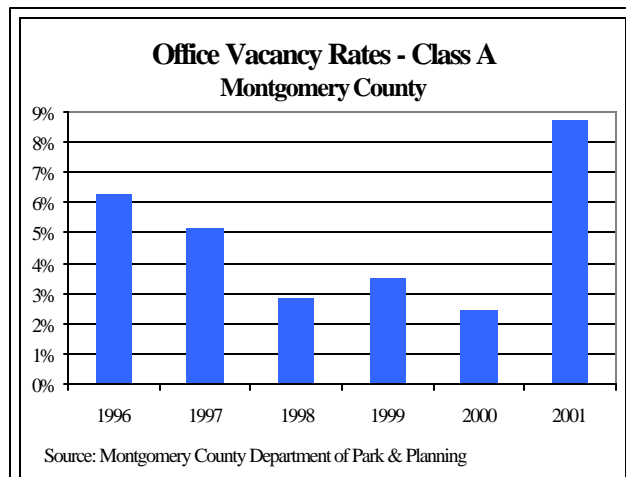
As a result of rapidly declining yields for the 10-year U.S. Treasury Note, used as a benchmark for mortgage lenders, mortgage interest rates dropped significantly. E.g., the 30-year fixed rate mortgage fell 190 basis points between June 2000 and November 2001, while adjustable rates fell from a 30% share of all mortgages to only 11%.

Since mortgage rates are benchmarked to treasuries, the 11 consecutive interest rate cuts by the Fed have no direct impact on mortgage rates. The recent decision by the Federal government to end 30-year treasuries, increased demand for the 10-year note, temporarily pushing prices up, and yields (and thus mortgage rates) down to record lows.



Strong economic growth through last year resulted in rapid absorption of available office space in the County. By December 2000, the vacancy rate for class A office space was only 2.5%, reflecting less than 0.7 million square feet. In fact, the 2.5% rate was well below the Washington region and all jurisdictions except for Arlington County.

By contrast, conditions changed significantly this year. At the same time that commercial office construction doubled this year by adding 2.6 million sq ft, the economy slowed dramatically and corporate profits fell sharply, pushing the vacancy rate for Class A space (8.7%) to the highest in six years.





SELECTED ECONOMIC INDICATORS	Reporting Period	Current Period	Prior Year's Period	Year To-Date			
				2001	2000	2000	
Leading Indicators							
National	December	1.2%		2.5%		-1.5%	
Washington MSA	October	0.4%		-5.2%		0.5%	
Consumer Confidence Index							
National	December	10.4%		-27.1%		-9.2%	
South Atlantic Region	December	13.3%		-23.3%		-9.9%	
Consumer Price Index							
All Items							
National	December	1.6%		2.9%		3.4%	
Washington - Baltimore CMSA	November	2.2%		2.7%		3.3%	
Core CPI							
National	December	2.7%		2.7%		2.4%	
Washington - Baltimore CMSA	November	3.6%		3.0%		2.3%	
Retail Trade							
National (sales)	December	2.9%		3.4%		7.6%	
Maryland (tax)	November	0.7%		3.3%		8.2%	
Montgomery County (tax)	November	2.0%		4.2%		6.6%	
Employment							
National	December	134,235,000	136,092,000	135,036,000	135,208,000	135,208,000	
- Percent Change		-1.4%		-0.1%		1.3%	
Washington PMSA (at place)	October	2,844,500	2,798,500	2,827,300	2,744,300	2,707,700	
- Percent Change		1.6%		3.0%		3.0%	
Montgomery County (resident)	November	487,132	484,407	488,611	472,752	473,902	
- Percent Change		0.6%		3.4%		1.3%	
Montgomery County (payroll)	June	456,983	453,448	449,003	442,268	447,744	
- Percent Change		0.8%		1.5%		4.9%	
Unemployment							
National	December	5.4%	3.7%	4.7%	4.0%	4.0%	
Maryland	November	4.2%	3.8%	3.9%	3.9%	3.9%	
Washington PMSA	October	3.4%	2.4%	2.6%	2.4%	2.3%	
Montgomery County	November	2.7%	1.8%	2.2%	1.9%	1.9%	
Construction							
Project Cost - Montgomery County							
Total (\$ thousand)	December	\$61,614	\$57,333	\$1,353,664	\$1,172,696	\$1,172,696	
- Percent Change		7.5%		15.4%		-19.3%	
Residential (\$ thousand)	December	\$29,154	\$34,578	\$682,768	\$582,335	\$582,335	
- Percent Change		-15.7%		17.2%		37.0%	
Non-Residential (\$ thousand)	December	\$32,460	\$22,755	\$670,896	\$590,361	\$590,361	
- Percent Change		42.6%		13.6%		-42.5%	
Building Permits (Residential)							
National	November	119,964	119,569	1,502,581	1,451,826	1,574,361	
- Percent Change		0.3%		3.5%		-5.4%	
Maryland	November	2,233	2,134	26,526	24,788	29,417	
- Percent Change		4.6%		7.0%		-1.1%	
Montgomery County	November	393	532	4,701	4,206	4,472	
- Percent Change		-26.1%		11.8%		6.7%	
Building Permits (Non-Residential)							
Montgomery County	December	148	133	2,102	1,697	1,697	
- Percent Change		11.3%		23.9%		28.7%	
Real Estate							
National							
Sales	November	5,210,000	5,300,000	5,250,000	5,140,000	5,113,000	
- Percent Change		-1.7%		2.1%		-1.8%	
Median Price	November	\$147,300	\$139,500	\$145,900	\$138,300	\$139,000	
- Percent Change		5.6%		5.5%		4.3%	
Montgomery County							
Sales	December	1,185	1,192	14,853	14,779	14,779	
- Percent Change		-0.6%		0.5%		0.4%	
Average Price	December	\$291,346	\$279,812	\$273,214	\$253,876	\$253,876	
- Percent Change		4.1%		7.6%		4.9%	
Median Price	December	\$230,000	\$200,000	\$210,133	\$190,000	\$190,000	
- Percent Change		15.0%		10.6%		2.7%	

### METROPOLITAN AREA OFFICE MARKET

#### Office Vacancy Rate by Jurisdiction and Class, 12/01

<i>Jurisdiction</i>	Class A	Class B	Class C	Total
Loudon	15.5%	15.6%	16.8%	15.6%
Fairfax	8.8%	6.9%	6.1%	8.2%
Frederick	8.3%	15.5%	13.4%	10.9%
Alexandria/Arlington	7.1%	5.4%	3.9%	6.0%
<b>Montgomery</b>	<b>8.7%</b>	<b>7.2%</b>	<b>12.2%</b>	<b>8.6%</b>
District of Columbia	5.2%	4.9%	8.2%	5.4%
Prince George's	6.4%	9.1%	16.5%	9.4%
<i>Metropolitan Area</i>	7.6%	6.4%	9.1%	7.3%

#### Vacant Office Space Inventory by Jurisdiction and Class (sq.ft.)

<i>Jurisdiction</i>	Class A	Class B	Class C	Total
Loudon	800,625	361,229	57,932	1,219,786
Fairfax	5,501,345	1,603,584	158,521	7,263,450
Frederick	176,654	156,479	48,877	382,010
Alexandria/Arlington	1,582,306	809,262	272,120	2,663,688
<b>Montgomery</b>	<b>2,568,554</b>	<b>1,452,512</b>	<b>800,447</b>	<b>4,821,513</b>
District of Columbia	2,844,774	2,065,608	1,023,646	5,934,028
Prince George's	565,884	493,172	653,952	1,713,008
<i>Metropolitan Area</i>	14,040,142	6,941,846	3,015,495	23,997,483

#### Office Space Inventory by Jurisdiction and Class (sq.ft.)

<i>Jurisdiction</i>	Class A	Class B	Class C	Total
Loudon	5,180,219	2,318,506	344,064	7,842,789
Fairfax	62,454,378	23,113,593	2,599,821	88,167,792
Frederick	2,126,814	1,007,587	363,628	3,498,029
Alexandria/Arlington	22,243,548	14,872,575	7,013,436	44,129,559
<b>Montgomery</b>	<b>29,499,719</b>	<b>20,273,255</b>	<b>6,562,084</b>	<b>56,335,058</b>
District of Columbia	54,293,663	42,288,304	12,451,827	109,033,794
Prince George's	8,908,779	5,409,596	3,956,289	18,274,664
<i>Metropolitan Area</i>	184,707,120	109,283,416	33,291,149	327,281,685

#### Share of Office Space Inventory by Jurisdiction and Class

<i>Jurisdiction</i>	Class A	Class B	Class C	Total
Loudon	66.1%	29.6%	4.4%	100.0%
Fairfax	70.8%	26.2%	2.9%	100.0%
Frederick	60.8%	28.8%	10.4%	100.0%
Alexandria/Arlington	50.4%	33.7%	15.9%	100.0%
<b>Montgomery</b>	<b>52.4%</b>	<b>36.0%</b>	<b>11.6%</b>	<b>100.0%</b>
District of Columbia	49.8%	38.8%	11.4%	100.0%
Prince George's	48.7%	29.6%	21.6%	100.0%
<i>Metropolitan Area</i>	56.4%	33.4%	10.2%	100.0%

Note:

Office Space inventory includes leasable and owner-occupied space.  
 Totals exclude non-classified space.  
 Vacant means "direct vacant" and does not include sublease space.

Source:

Montgomery County Department of Planning, Research and Technology Center  
 Data compiled from Realty Information Group commercial space data file, 12/25/01